CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

August 11, 2006

H.R. 5637
Nonadmitted and Reinsurance Reform Act of 2006

As ordered reported by the House Committee on Financial Services on July 26, 2006

SUMMARY

H.R. 5637 would create a uniform system for taxing and regulating certain types of insurance products. Specifically, the bill would establish national standards for how states may regulate, collect, and allocate taxes for a type of insurance that covers unique or atypical risks —known as "surplus lines" or "nonadmitted insurance." The bill also would establish national standards for how states regulate reinsurance—often referred to as insurance for insurance companies. In addition, the legislation would require a study by the Government Accountability Office (GAO) of the admitted and nonadmitted insurance market.

CBO estimates that enacting H.R. 5637 would increase federal revenues by $5 million to $10 million a year over the 2008-2016 period because the bill would prohibit states from collecting taxes on certain insurance products, and that change would in turn reduce federal tax deductions of insurance companies, resulting in higher taxable income for federal purposes. (The bill would have no effect on 2007 revenues because the bill would take effect 12 months after enactment.) The bill would have no significant impact on federal spending because enforcement of the insurance tax system would rest with the states rather than with any federal agency.

By prohibiting states from taxing and regulating certain insurance products issued by companies not based in those states, H.R. 5637 would impose intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). Although the aggregate costs to state governments of complying with these mandates is uncertain, CBO estimates that they likely would not exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation). The bill contains no new private-sector mandates as defined in UMRA.

ESTIMATED IMPACT ON THE FEDERAL BUDGET

CBO expects that enacting H.R. 5637 would reduce payments of certain state taxes by insurance companies. These lower payments would, in turn, reduce deductions made by insurance companies for federal taxes and raise taxable income for federal purposes. State governments would likely adjust their finances as a result of these lost revenues. They would likely achieve this through some mix of reduced spending and higher taxes and fees—both deductible and nondeductible. This response by state governments would mute, but not eliminate, the revenue gain to the federal government. CBO estimates that H.R. 5637 would result in an increase in federal revenues of between $5 million and $10 million per year starting in 2008.

H.R. 5637 would require GAO to conduct a study to determine how implementing the provisions of this bill would affect both the admitted and nonadmitted insurance market. Subject to the availability of appropriated funds, the cost of this study would be less than $500,000, CBO estimates.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 5637 would create a uniform system for taxing and regulating certain types of insurance products. Specifically, the bill would establish national standards for how states may regulate, collect, and allocate taxes for a type of insurance that covers unique or atypical risks —known as surplus lines or nonadmitted insurance. The bill also would establish national standards for how states regulate reinsurance.

Under current law, states use a variety of laws to regulate and tax these products. By preempting such laws and making the state of domicile the only state with regulatory or taxing power, H.R. 5637 contains intergovernmental mandates as defined in UMRA. Those mandates would result in forgone revenues to the more than 40 states that have a taxing regime different from what would be allowed under the bill.

Specifically, provisions in the bill would:

- Prohibit states from taxing and regulating certain insurance products issued by companies not based in the state;

- Prohibit states from collecting fees from certain brokers of insurance unless states participate in a database of national insurance producers for the licensing of surplus lines brokers and the renewal of those licenses;

- Preempt laws in at least 40 states regarding how insurance polices with multistate risks are taxed and how those taxes are distributed among states; and

- Preempt laws in at least 14 states regarding certain requirements for reinsurance.

Estimated Direct Costs of Mandates to State and Local Governments

UMRA includes in its definition of the direct costs of a mandate the amounts that state and local governments would be prohibited from raising in revenues as a result of the mandate. The direct mandate costs of H.R. 5637 would be forgone revenues that state governments are currently collecting from taxes on insurance premiums issued by certain out-of-state brokers but would be precluded from collecting under the bill.

CBO estimates that enacting H.R. 5637 would result in state revenue losses that likely would approach but not exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation). While there is some uncertainty surrounding the amount of tax currently being collected by states, the portion of the surplus lines market that would be affected by the regulatory changes in the bill, and the extent of flexibility that would be available to states after enactment of the bill, CBO estimates that forgone revenues would total less than $50 million, annually, beginning one year after enactment. For the purposes of estimating the direct costs of these mandates, CBO considered only the revenues from taxes that industry estimates it is paying and only the revenues that states, as a whole, would no longer be able to collect as a result of the bill.

Other Impacts on State and Local Governments

Over time, CBO expects that states would either join the compact authorized by the bill or change their statutes to reflect the requirements set forth in the bill. Such changes would likely lead to less complexity in the regulation of certain forms of insurance and would mitigate at least some of the tax losses. Such changes, however, could take between three and five years to carry out.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

The bill contains no new private-sector mandates as defined in UMRA.

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